

pursuant to TEFRA section 208(d)(2)(B), the provisions of section 168(f)(8)(J), but not the provisions of section 168(i)(1), will apply only to such property. If the general transitional rule does not apply to a specific mass commuting vehicle, the provision of section 168(i)(1) applies to the lessor who leases such vehicle.

Q-18: Does the definition of a qualified mass commuting vehicle include component parts of a qualified mass commuting vehicle—such as an undercarriage of a subway car or the costs of rehabilitation or reconstruction of a mass commuting vehicle (or component part thereof)?

A-18: Yes.

[T.D. 7850, 47 FR 50853, Nov. 10, 1982, as amended by T.D. 7879, 48 FR 11942, Mar. 22, 1983]

PART 6a—TEMPORARY REGULATIONS UNDER TITLE II OF THE OMNIBUS RECONCILIATION ACT OF 1980

Sec.

6a.103A-1 Interest on mortgage subsidy bonds.

6a.103A-2 Qualified mortgage bond.

6a.103A-3 Qualified veterans' mortgage bonds.

6a.6652(g)-1 Failure to make return or furnish statement required under section 6039C.

AUTHORITY: 26 U.S.C. 7805.

Sections 6a.103A-2(k), (l), and (m) also issued under 26 U.S.C. 103A(j) (3), (4), and (5).

§ 6a.103A-1 Interest on mortgage subsidy bonds.

(a) *In general*—(1) *Mortgage subsidy bond*. A mortgage subsidy bond shall be treated as an obligation not described in section 103 (a)(1) or (a)(2). Thus, the interest on a mortgage subsidy bond is includable in gross income and subject to Federal income taxation.

(2) *Exceptions*. Any qualified mortgage bond and any qualified veterans' mortgage bond shall not be treated as a mortgage subsidy bond. See § 6a.103A-2 with respect to requirements of qualified mortgage bonds and § 6a.103A-3 with respect to requirements of qualified veterans' mortgage bonds.

(3) *Additional requirement*. In addition to the requirements of § 6a.103A-2, § 6a.103A-3, and this section, qualified mortgage bonds and qualified veterans' mortgage bonds shall be subject to the requirements of section 103(c) and the regulations thereunder.

(4) *Advance refunding*. On or after December 5, 1980, no tax-exempt obligation may be issued for the advance refunding of a mortgage subsidy bond (determined without regard to section 103A(b)(2) or § 6a.103A-1(a)(2)). An obligation issued for the refunding of a mortgage subsidy bond will be considered to be an advance refunding obligation if it is issued more than 180 days before the prior issue is discharged.

(5) *Registration*. Any obligation that is part of a qualified mortgage bond issue or qualified veterans' mortgage bond issue and which is issued after December 31, 1981, must be in registered form. The term "in registered form" has the same meaning as in § 1.6049-2(d). Thus, in general, an obligation is issued in registered form if it is registered as to both principal and interest and if its transfer must be effected by the surrender of the old instrument to the issuer and by either the reissuance of the old instrument to a new holder or the issuance of a new instrument to a new holder.

(b) *Definitions*. For purposes of §§ 6a.103A-2, 6a.103A-3, and this section the following definitions apply:

(1) *Mortgage subsidy bond*. (i) The term "mortgage subsidy bond" means any obligation which is issued as part of an issue a significant portion of the proceeds of which is to be used directly or indirectly to provide mortgages on owner-occupied residences.

(ii) For purposes of subdivision (i), a significant portion of the proceeds of an issue is used to provide mortgages if 5 percent or more of the proceeds are so used.

(2) *Mortgage*. The term "mortgage" includes deeds of trust, conditional sales contracts, pledges, agreements to hold title in escrow, and any other form of owner financing.

(3) *Bond*. The term "bond" means any obligation. The term "obligation" means any evidence of indebtedness.

(4) *State*. (i) The term "State" includes a possession of the United States and the District of Columbia.

(ii) For purposes of subdivision (i), obligations issued by or on behalf of any State or local governmental unit by constituted authorities empowered

to issue such obligations are the obligations of such governmental unit. See § 1.103-1(b).

(5) *Proceeds.* The term “proceeds” includes original proceeds and investment proceeds. The terms “original proceeds” and “investment proceeds” shall have the same meaning as in § 1.103-13(b)(2). Unless otherwise provided in § 6a.103A-2 or this section, however, amounts earned from the investment of proceeds which are derived from qualified mortgage bonds in non-mortgage investments may not be commingled for the purposes of accounting for expenditures with other non-bond amounts, and such proceeds are investment proceeds even though not treated as investment proceeds for purposes of section 103(c). Repayments of principal on mortgages shall be treated as proceeds of an issue. Amounts (such as State appropriations or surplus funds) which are provided by the issuer or a private lender in conjunction with a qualified mortgage bond or a qualified veterans’ mortgage bond shall not be treated as proceeds of a mortgage subsidy bond under this section. However, fees which are paid by a participating financial institution pursuant to an agreement with the issuer whereby such institution receives the right to originate or service mortgages and which are retained by an issuer are treated as original proceeds of the issue. Amounts provided by the issuer or a private lender may be treated as proceeds of an issue for purposes of section 103(c).

(6) *Single-family and owner-occupied residences.* Except for purposes of § 6a.103A-2 (g) and (h)(2)(ii), the terms “single-family” and “owner-occupied,” when used with respect to residences, include two-, three-, and four-family residences—

(i) One unit of which is occupied by the owner of the units, and

(ii) Which were first occupied as a residence at least 5 years before the mortgage is executed.

[T.D. 7780, 46 FR 34314, July 1, 1981; 46 FR 37890, July 23, 1981, as amended by T.D. 7794, 46 FR 55514, Nov. 10, 1981]

§ 6a.103A-2 Qualified mortgage bond.

(a) *In general.*—(1) *Qualified mortgage bond.* A qualified mortgage bond shall

not be treated as a mortgage subsidy bond, and the interest on a qualified mortgage bond will be exempt from Federal income taxation.

(2) *Termination date.* No obligation issued after December 31, 1987, shall be treated as part of a qualified mortgage bond issue.

(b) *Definitions and special rules.* For purposes of this section and § 6a.103A-1, the following definitions apply:

(1) *Qualified mortgage bond.* The term “qualified mortgage bond” means one or more obligations issued by a State or any political subdivision thereof (hereinafter referred to as “governmental unit”) as part of an issue—

(i) All of the original proceeds of which, net of the costs of issuing the obligations and proceeds invested in a reasonably required reserve fund (such net amount hereinafter in this section referred to as “lendable proceeds”), are to be used to finance owner-occupied residences, and

(ii) Which meets each of the requirements of § 6a.103A-1 and this section.

A qualified mortgage bond does not include any bond that is an industrial development bond under section 103(b).

(2) *Constitutional home rule city.* The term “constitutional home rule city” means, with respect to any calendar year, any political subdivision of a State which, under a State constitution which was adopted in 1970 and effective on July 1, 1971, had home rule powers on the 1st day of the calendar year.

(3) *Targeted area residence.* The term “targeted area residence” means a residence in an area which is either—

(i) A qualified census tract, or

(ii) An area of chronic economic distress.

(4) *Qualified census tract.* (i) The term “qualified census tract” means a census tract in which 70 percent or more of the families have an income which is 80 percent or less of the State-wide median family income.

(ii) The determination under subdivision (i) shall be made on the basis of the most recent decennial census for which data are available. With respect to any particular bond issue, such determination may be based upon the decennial census data available 3 months prior to the date of issuance and shall

not be affected by official changes to such data during or after such 3-month period.

(iii) The term “census tract” means a census tract as defined by the Secretary of Commerce.

(5) *Areas of chronic economic distress.*

(i) The term “area of chronic economic distress” means an area designated by a State as meeting the standards established by that State for purposes of this subparagraph and approved by the Secretary and by the Secretary of Housing and Urban Development in accordance with the criteria set forth in (iii) of this subparagraph. A State may withdraw such designation at any time, with reasonable cause. Such withdrawal shall be effective upon notification by the State to the Assistant Secretary for Housing/Federal Housing Commissioner of the Department of Housing and Urban Development. Such withdrawal shall not affect the tax-exempt status of any outstanding issue of obligations.

(ii) For purposes of making a designation under this subparagraph, withdrawing a designation, or making any other submission, “State” means the governor of a State, or a State official commissioned by the governor or by State statute for such purposes.

(iii) The following criteria will be used in evaluating a proposed designation of an area of chronic economic distress:

(A) The condition of the housing stock, including the age of the housing and the number of abandoned and substandard residential units. Data pertinent to this criterion include the number and percentage of housing units that were constructed prior to 1940, the average age of the housing stock, the number and percentage of abandoned housing units, and the number and percentage of substandard residential units.

(B) The need of area residents for owner financing under a qualified mortgage bond issue as indicated by low per capita income, a high percentage of families in poverty, a high number of welfare recipients, and high unemployment rates. Data pertinent to this criterion include the per capita income of the population in the area, the number and percentage of families eli-

gible to receive food stamps from a program pursuant to 7 U.S.C. 2011, the number and percentage of families eligible to receive payments under the Aid to Families with Dependent Children program, and the unemployment rate.

(C) The potential for use of owner financing under a qualified mortgage bond issue to improve housing conditions in the area. Data pertinent to this criterion include the number and percentage of owner-occupied homes that are substandard, the number and percentage of families that are low- or moderate-income renters, and the number and percentage of substandard units in the area that will be improved through the use of owner financing provided by the proceeds of a qualified mortgage bond issue.

(D) The existence of a housing assistance plan which provides a displacement program and a public improvements and services program (similar to the Housing Assistance Plan (HAP) required by the Department of Housing and Urban Development under the Community Development Block Grant program (42 U.S.C. 5301 *et seq.*)).

This determination shall be based upon the most recent data available. The certification described in subdivision (iv)(C) shall satisfy the criteria set forth in subdivisions (C) and (D). A certification described in (iv)(D) shall satisfy the criteria set forth in subdivisions (A) and (B): *Provided*, That the majority of the households in the proposed area have incomes less than 80 percent of the median income for the standard metropolitan statistical area (SMSA) in which the proposed area is located or, if the proposed area is not within a SMSA, less than 80 percent of the median income for the State.

(iv) A proposal by the State that an area be approved as an area of chronic economic distress shall contain the following information:

(A) A description of the proposed area by its geographical limits.

(B) Maps of the State and of areas within the State that are qualified census tracts and existing or proposed areas of chronic economic distress.

(C) Where applicable, a certification of the local Area Manager of the Department of Housing and Urban Development in which the proposed area is located that the proposed area is a Neighborhood Strategy Area (NSA) under 24 CFR 570.301(c) promulgated pursuant to the Community Development Block Grant program or an area comparable to a NSA which has been reviewed and approved by the Area Manager as meeting the standards for an NSA.

(D) Where applicable, a certification from the HUD Area Manager with jurisdiction over the proposed area that the proposed area is within a geographic area which has been declared eligible for grants under the Urban Development Action Grant Program, Pursuant to 24 CFR 570.452, by the Secretary of Housing and Urban Development.

(E) Statistical and descriptive information pertinent to the criteria enumerated in subdivision (iii) of this subparagraph, and a succinct statement of how the information furnished satisfies those criteria. Such statistical information shall be based upon the most recent data available.

(F) If the State so desires, a written request for a conference prior to any adverse decision on the proposed designation.

(G) A certification by the Governor or designated official that the proposed designation conforms to these regulations.

(v) The proposed designation and the information furnished with it as required by subdivision (iv) of this subparagraph shall be submitted in triplicate to the Assistant Secretary for Housing/Federal Housing Commissioner of the Department of Housing and Urban Development (Attention: Office of State Agency and Bond Financed Programs, Rm. 6138, 451 7th Street, SW., Washington, D.C. 20410).

(vi) Only those areas of chronic economic distress that have been previously designated by the State and approved in accordance with this subparagraph at least 3 months prior to the date of issuance need to be taken into account for any particular bond issue. Residences located in areas designated as areas of chronic economic

distress approved in accordance with this subparagraph within such 3-month period or after the date of issue, however, may be treated as targeted area residences. However, for purposes of paragraph (h)(2), relating to the specified portion of proceeds to be placed in targeted areas, and paragraph (i)(3)(ii)(A), relating to the 1½ year temporary period, only areas approved as areas of chronic economic distress in accordance with this subparagraph at the time of issue may be taken into consideration.

(6) *Standard metropolitan statistical area.* A standard metropolitan statistical area ("SMSA") is an area in and around a city of 50,000 inhabitants or more (or equivalent area) and defined by the Secretary of Commerce as an SMSA.

(7) *Statistical area.* The term "statistical area" means—

(i) An SMSA,

(ii) Any county (or portion thereof) which is not within an SMSA, or

(iii) If there is insufficient recent statistical information with respect to a county (or portion thereof) described in subdivision (ii) of this subparagraph, such other area as may be designated by the Commissioner, upon proper application, as a substitute for such county (or portion thereof).

For purposes of subdivisions (ii) and (iii) of this subparagraph, in Alaska, the entire State, and in Louisiana, a parish, shall be treated in a manner similar to a county.

(8) *Acquisition cost.* (i) The term "acquisition cost" means the cost of acquiring a residence from the seller as a completed residential unit. Acquisition cost includes the following:

(A) All amounts paid, either in cash or in kind, by the purchaser (or a related party or for the benefit of the purchaser) to the seller (or a related party or for the benefit of the seller) as consideration for the residence.

(B) If a residence is incomplete, the reasonable cost of completing the residence whether or not the cost of completing construction is to be financed with bond proceeds. For example, where a mortgagor purchases a building which is so incomplete that occupancy of the building is not permitted under local law, the acquisition cost

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includes the cost of completing the building so that occupancy of the building is permitted.

(C) Where a residence is purchased subject to a ground rent, the capitalized value of the ground rent. Such value shall be calculated using a discount rate equal to the yield on the issue (as defined in § 6a.103A-2(i)(2)(vi)).

(ii) The term “acquisition cost” does not include the following:

(A) The usual and reasonable settlement or financing costs. Settlement costs include titling and transfer costs, title insurance, survey fees, or other similar costs. Financing costs include credit reference fees, legal fees, appraisal expenses, “points” which are paid by the buyer (but not the seller, even though borne by the mortgagor through a higher purchase price) or other costs of financing the residence. However, such amounts will be excluded in determining acquisition cost only to the extent that the amounts do not exceed the usual and reasonable costs which would be paid by the buyer where financing is not provided through a qualified mortgage bond issue. For example, if the purchaser agrees to pay to the seller more than a pro rata share of property taxes, such excess shall be treated as part of the acquisition cost of a residence.

(B) The value of services performed by the mortgagor or members of the mortgagor’s family in completing the residence. For purposes of the preceding sentence, the family of an individual shall include only the individual’s brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants. For example, where the mortgagor builds a home alone or with the help of family members, the acquisition cost includes the cost of materials provided and work performed by subcontractors (whether or not related to the mortgagor) but does not include the imputed cost of any labor actually performed by the mortgagor or a member of the mortgagor’s family in constructing the residence. Similarly, where the mortgagor purchases an incomplete residence the acquisition cost includes the cost of material and labor paid by the mortgagor to complete the residence but does not include the imputed value of

the mortgagor’s labor or the labor of the mortgagor’s family in completing the residence.

(C) The cost of land which has been owned by the mortgagor for at least 2 years prior to the date on which construction of the residence begins.

(iii) The following examples illustrate the provisions of subparagraph (8):

Example (1). A contracts with B, a builder of single-family residences, for the purchase of a residence. Under the terms of the contract, B will deliver a residential unit to A that contains an uncompleted recreation room and an unfinished third floor and which lacks a garage. Normally, a completed recreation room, a finished third floor and a garage are provided as part of the residence built by B. The contract price for the residence is \$58,000. At the same time, A contracts with C, an affiliate of B, to complete the recreation room and third floor and to construct the garage for a contract price of \$10,000. C will perform this work after A receives title to the unit from B. Under § 6a.103A-2(b)(8)(i)(A), the acquisition cost of A’s completed residential unit is \$68,000, which represents the contract price of the residence plus the cost of completion of the recreation room and third floor and construction of the garage.

Example (2). E owns a single-family residence which E has listed for sale. D contracts to purchase E’s residence, and the contract provides for a selling price of \$30,000. D also agrees to pay an unsecured debt in the amount of \$5,000, which E owes to X, a local bank. D further agrees to purchase from E the refrigerator, stove, washer, and dryer located in E’s residence for \$500. Such amount is equal to the fair market value of such personalty. D also agrees to purchase the light fixtures, curtain rods, and wall-to-wall carpeting for a fair market value price of \$700. Under § 6a.103A-2(b)(8)(i)(A), the acquisition cost of D’s completed residential unit is \$35,700. Such amount includes the \$5,000 unsecured debt paid off by D. The \$500 paid for the refrigerator, stove, washer, and dryer are not included because such items are not included within the definition of a residence under § 6a.103A-2(d)(4). Such definition does include, however, the light fixtures, curtain rods, and wall-to-wall carpeting purchased by D.

Example (3). F contracts with G to purchase G’s home for \$40,000. After purchasing the residence, F pays a party unrelated to G \$3,000 for painting, minor repairs, and refinishing the floors. Under § 6a.103A-2(b)(8)(i)(A), the acquisition cost of the residence is \$40,000. Such fix-up expenses are not treated as part of the acquisition costs. If G had incurred such fix-up expenses, however,

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F may not reduce his acquisition cost of the residence by such amounts.

(9) *Qualified home improvement loan.*

(i) The term “qualified home improvement loan” means the financing (whether or not secured by a mortgage), in an amount which does not exceed \$15,000 with respect to any residence, of alterations, repairs, and improvements on, or in connection with, an existing single-family, owner-occupied residence by the owner thereof, but only if such items substantially protect or improve the basic livability or energy efficiency of the residence.

(ii) Alterations, repairs, or improvements that satisfy the requirement of subdivision (i) of this subparagraph include the renovation of plumbing or electric systems, the installation of improved heating or air conditioning systems, the addition of living space, or the renovation of a kitchen area. Items that will not be considered to substantially protect or improve the basic livability of the residence include swimming pools, tennis courts, saunas, or other recreational or entertainment facilities.

(iii) If—

(A) Two or more qualified home improvement loans are provided for the same residence, whether or not by the same lender, and

(B) Any person who had a present ownership interest in such residence at the time the previous qualified home improvement loan or loans were made has a present ownership interest in the residence at the time the subsequent qualified home improvement loan is made,

Then the allowable amount of the subsequent qualified home improvement loan shall be reduced by the amount, at origination, of any previous qualified home improvement loan, so that the sum of such loans does not exceed \$15,000.

(iv) The following example illustrates the provisions of subparagraph (9):

Example. A and B jointly own a residence located in Town M. They obtain a qualified home improvement loan for \$10,000 from Town M. A acquires B’s interest in the residence. A applies to State X for a qualified home improvement loan. The maximum amount of a qualified home improvement loan which may be made by State X is \$5,000,

the amount that when added to the \$10,000 previous loan from Town M does not exceed \$15,000.

(10) *Qualified rehabilitation loans.* (i)

The term “qualified rehabilitation loan” means any owner financing provided in connection with—

(A) A qualified rehabilitation, or

(B) The acquisition of a residence with respect to which there has been a qualified rehabilitation,

But only if the mortgagor to whom such financing is provided is the first resident of the residence after completion of the rehabilitation. Where there are two or more mortgagors of a rehabilitation loan, the first residency requirement is met if any of the mortgagors meets the first residency requirement.

(ii) The term “qualified rehabilitation” means any rehabilitation of a residence if—

(A) There is a period of at least 20 years between the date on which the building was first used and the date on which physical work on such rehabilitation begins,

(B) 75 percent or more of the existing external walls of such building are retained in place as external walls in the rehabilitation process, and

(C) The expenditures for such rehabilitation are 25 percent or more of the mortgagor’s adjusted basis in the residence (including the land on which the residence is located).

(iii) For purposes of (A) and (B), the rules applicable to the investment tax credit for qualified rehabilitated buildings under section 48(g)(1) (A)(iii) and (B) shall apply. However, unlike section 48(g)(1)(B), once a building meets the 20-year test, more than one rehabilitation of that building within a 20-year period may qualify as a qualified rehabilitation.

(iv) The adjusted basis to the mortgagor is the mortgagor’s adjusted basis for purposes of determining gain or loss on the sale or exchange of a capital asset (as defined in section 1221). The mortgagor’s adjusted basis shall be determined as of the date of completion of the rehabilitation, or, if later, the date the mortgagor acquires the residence, *i.e.*, the date on which the mortgagor includes in basis any amounts

expended for rehabilitation that are expended for capital assets.

(v) The amounts expended by the mortgagor for rehabilitation include all amounts expended for rehabilitation regardless of whether the amounts expended were financed from the proceeds of the loan or from other sources, and regardless of whether the expenditure is a capital expenditure, so long as the expenditure is made during the rehabilitation of the residence and is reasonably related to the rehabilitation of the residence. The value of services performed by the mortgagor or members of the mortgagor's family (as used in § 6a.103A-2(b)(8)(ii)(B)) in rehabilitating the residence will not be included in determining the rehabilitation expenditures for purposes of the 25-percent test.

(vi) Where a mortgagor purchases a residence that has been substantially rehabilitated, the 25-percent test is determined by comparing the total expenditures made by the seller for the rehabilitation of the residence with the acquisition cost of the residence to the mortgagor. The total expenditures made by the seller for rehabilitation do not include the cost of acquiring the building or land but do include all amounts directly expended by the seller in rehabilitating the building (excluding overhead and other indirect charges).

(c) *Good faith compliance efforts*—(1) *Mortgage eligibility requirements.* An issue of qualified mortgage bonds which fails to meet one or more of the requirements of paragraphs (d), (e), (f), and (j) of this section shall be treated as meeting such requirements if each of the following provisions is met.

(i) The issuer in good faith attempted to meet all such requirements before the mortgages were executed. Good faith requires that the trust indenture, participation agreements with loan originators, and other relevant instruments contain restrictions that permit the financing of mortgages only in accordance with such requirements. In addition, the issuer must establish reasonable procedures to ensure compliance with such requirements. Such procedures include reasonable investigations by the issuer or its agent to de-

termine that the mortgages satisfy such requirements.

(ii) Ninety-five percent or more of the lendable proceeds (as defined in § 6a.103A-2(b)(1)) that were devoted to owner financing were devoted to residences with respect to which, at the time the mortgages were executed or assumed, all such requirements were met. In determining whether the proceeds are devoted to owner financing which meets such requirements, the issuer may rely on an affidavit of the mortgagor that the property is located within the issuer's jurisdiction and an affidavit of the mortgagor and the seller that the requirements of § 6a.103A-2(f) are met. The issuer may also rely on his own or his agent's examination of copies of income tax returns which were filed with the Internal Revenue Service and which are provided by the mortgagor or obtained by the issuer or loan originator in accordance with the procedures set forth in § 301.6103(c)-1 which indicate that, during the preceding 3 years, the mortgagor did not claim deductions for taxes or interest on indebtedness with respect to real property constituting his principal residence, in addition to an affidavit of the mortgagor that the requirements of § 6a.103A-2(e) are met. The mortgagor may also provide the issuer or his agent with an affidavit that the mortgagor was not required to file such return in accordance with section 6012 during one or all of the preceding 3 years. Where a particular mortgage fails to meet more than one of these requirements, the amount of the mortgage will be taken into account only once in determining whether the 95-percent requirement is met. However, all of the defects in the mortgage must be corrected pursuant to paragraph (c)(1)(iii) of this section.

(iii) Any failure to meet such requirements is corrected within a reasonable period after such failure is discovered. For example, where a mortgage fails to meet one or more of such requirements those failures can be corrected by calling the nonqualifying mortgage or by replacing the nonqualifying mortgage with a qualifying mortgage.

(iv) *Examples.* The following examples illustrate the application of paragraph (c)(1) of this section:

Example (1). State X issues obligations to be used to provide mortgages for owner-occupied residences. X contracts with bank M to originate and service the mortgages. The trust indenture and participation agreement require that the mortgages meet the mortgage eligibility requirements referred to in paragraph (c)(1). In addition, pursuant to procedures established by X, M obtains a signed affidavit from each applicant that the applicant intends to occupy the property as his or her principal residence within 60 days after the final closing and thereafter to maintain the property as his or her principal residence. Further, M obtains from each applicant copies certified by the Internal Revenue Service of the applicant's Federal tax returns for the preceding 3 years and examines each statement to determine whether the applicant has claimed a deduction for taxes on real property which was the applicant's principal residence pursuant to section 164(a)(1) or a deduction pursuant to section 163 for interest paid on a mortgage secured by real property which was the applicant's principal residence. Also in accordance with X's procedures, M obtains from each applicant a signed affidavit as to facts that are sufficient for M to determine whether the residence is located within X's jurisdiction and affidavits from the seller and the buyer that the purchase price and the new mortgage requirements have been met, and neither M nor X knows or has reason to believe that such affidavits are false. The mortgage instrument provides that the mortgage may not be assumed by another person unless X determines that the principal residence, 3-year, and purchase price requirements are met at the time of the assumption. These facts are sufficient evidence of the good faith of the issuer and meet the requirements of paragraph (c)(1)(i). Further, if 95 percent of the lendable proceeds are devoted to owner financing which according to these procedures meet the requirements of paragraphs (d), (e), (f), and (i), then the issue meets the requirements of paragraph (c)(1)(ii).

Example (2). State Y issues obligations to be used to provide mortgages for owner-occupied residences. Y contracts with bank N to originate and service the mortgages. The trust indenture and participation agreement require that the mortgagor certify compliance with the requirements referred to in paragraph (c)(1). By itself, this certification is not sufficient evidence of the good faith of the issuer to meet the requirements referred to in paragraph (c)(1).

Example (3). The facts are the same as in Example 1, except that M discovers through a verification procedure required by X that, at the time of closing, A fraudulently executed the residence affidavit. Instead of occupying the property as a principal residence, A leased the property to B for one

year. A did not use the property as his residence during the lease term. Thus, at the time that A's mortgage was executed the residence failed to meet the requirements of paragraph (d) of this section.

More than 95 percent of the lendable proceeds of the issue were devoted to residences which met all the requirements referred to in paragraph (c)(1) at the time the mortgages were executed. Furthermore, pursuant to a provision in the mortgage instrument M called the loan. Any failures with respect to other mortgages are corrected by M. Based on these facts, the issue meets the requirements of subparagraph (c)(1).

Example (4). The facts are the same as in Example (1), except that the issuer requires copies of the applicant's signed tax returns that were filed with the Internal Revenue Service for the preceding 3 years but does not require that such returns be certified. If 95 percent of the lendable proceeds are devoted to owner financing which according to these procedures meet the requirements of paragraphs (d), (e), (f), and (i), then the issue meets the requirements of paragraph (c)(1)(ii).

(2) *Nonmortgage eligibility requirements.* An issue of qualified mortgage bonds which fails to meet one or more of the requirements of paragraphs (g), (h), and (i) of this section and § 6a.103A-1(a)(5) shall be treated as meeting such requirements if each of the following provisions is met.

(i) The issuer in good faith attempted to meet all such requirements. This good faith requirement will be met if all reasonable steps are taken by the issuer to ensure that the issue complies with these requirements.

(ii) Any failure to meet such requirements is due to inadvertent error, *e.g.*, mathematical error, after taking reasonable steps to comply with such requirements.

(iii) The following examples illustrate the application of this subparagraph (2):

Example (1). City X issues obligations to finance owner-occupied residences. However, despite taking all reasonable steps to determine accurately the size of the market share limitation, as provided in paragraph (g)(3), the limit is exceeded because the amount of the mortgages originated in the area during the past 3 years is incorrectly computed as a result of mathematical error. Such facts are sufficient evidence of the good faith of the issuer to meet the requirements of paragraph (c)(2).

Example (2). City Y issues \$25 million of bonds to finance single-family, owner-occupied homes. Attorney A gives an opinion that the bonds satisfy the arbitrage requirements of § 6a.103A-2(i) and § 6a.103A-1(a)(3). In fact, however, the legal conclusion reached by A is erroneous, and the bonds do not meet the requirements of § 6a.103A-2(i). The issue does not meet the requirements of subparagraph (c)(2) because the erroneous opinion does not constitute inadvertent error.

(d) *Residence requirements*—(1) *In general.* An issue meets the requirements of this paragraph only if all of the residences for which owner financing is provided under the issue meet the requirements of this paragraph. A residence meets the requirements of this paragraph only if—

(i) It is a single-family residence (as defined in § 6a.103A-1(b)(6)) which, at the time the mortgage is executed or assumed, can reasonably be expected by the issuer to become the principal residence of the mortgagor within a reasonable time after the financing is provided; and

(ii) It is located within the jurisdiction of the authority issuing the obligation.

(2) *Affidavit.* The requirements of subparagraph (1)(i) of this paragraph may normally be met if the mortgagor executes an affidavit of his intent to use the residence as his principal residence within a reasonable time (*e.g.*, 60 days) after the financing is provided.

(3) *Principal residence.* Whether a residence is used as a principal residence depends upon all the facts and circumstances of each case, including the good faith of the mortgagor. A residence which is primarily intended to be used in a trade or business shall not satisfy the requirements of this paragraph. For purposes of the preceding sentence, any use of a residence which does not qualify for a deduction allowable for certain expenses incurred in connection with the business use of a home under section 280A shall not be considered as a use in a trade or business. Except for certain owner-occupied residences described in paragraph (b)(6) of § 6a.103A-1, a residence more than 15 percent of the total area of which is reasonably expected to be used primarily in a trade or business does not satisfy the requirements of this subparagraph. Further, a residence used as

an investment property or a recreational home does not satisfy the requirements of this subparagraph.

(4) *Residence.* (i) The term “residence” includes stock held by a tenant-stockholder in a cooperative housing corporation (as those terms are defined in section 216(b) (1) and (2)). It does not include property such as an appliance, a piece of furniture, a radio, etc., which, under applicable local law, is not a fixture. The term also includes factory-made housing which is permanently fixed to real property. The determination of whether factory-made housing is permanently fixed to real property shall be made on the basis of the facts and circumstances of each particular case.

(ii) *Land.* Land appurtenant to a residence shall be considered as part of the residence only if such land reasonably maintains the basic livability of the residence and does not provide, other than incidentally, a source of income to the mortgagor.

(5) *Examples.* The following examples illustrate the application of this paragraph (d):

Example (1). A contracts to purchase a new residence from B. Since B is unable to move from the residence until 1 month after the scheduled closing date, A agrees to lease the residence to B for 1 month at a rent equal to the fair rental value. A applies for a mortgage to be provided from the proceeds of a qualified mortgage bond. In light of all the facts and circumstances in the case, the fact that A temporarily leases the residence to B does not prevent the residence from being considered as property that can reasonably be expected to be used as A’s principal residence within a reasonable period of time after financing is provided.

Example (2). C contracts to purchase a new residence located on 2 acres of land in city X. City X has a zoning regulation which prevents the subdividing of any lot in that part of the city for use as a private residence into parcels of less than 2 acres. In light of all the facts and circumstances in the case, the fact that the residence is located on 2 acres of land appurtenant to the residence does not prevent the entire property from being considered as property to be used by C as a residence.

Example (3). D contracts to purchase a new residence located on 40 acres of land that D intends to farm. Any financing provided for the purchase of that portion of the property intended to be farmed will not be considered

as financing provided for an owner-occupied residence.

(e) *3-year requirement*—(1) *In general.* An issue meets the requirements of this paragraph only if each of the mortgagors to whom owner financing is provided under the issue meets the requirements of this paragraph. A mortgagor meets the requirements of this paragraph only if the mortgagor had no present ownership interest in a principal residence at any time during the 3-year period prior to the date on which the mortgage is executed. For purposes of the preceding sentence, the mortgagor's interest in the residence with respect to which the financing is being provided shall not be taken into account.

(2) *Exceptions.* Subparagraph (1) shall not apply with respect to—

(i) Any financing provided with respect to a targeted area residence (as defined in § 6a.103A-2(b)(3)),

(ii) Any qualified home improvement loan (as defined in § 6a.103A-2(b)(9)), and

(iii) Any qualified rehabilitation loan (as defined in § 6a.103A-2(b)(10)).

(3) *Multiple mortgagors.* In the event that there is more than one mortgagor with respect to a particular residence, each of such mortgagors must meet the 3-year requirement. A person who is liable under a note secured by the mortgage but who does not have a present ownership interest in a residence subject to the mortgage need not meet the 3-year requirement. For example, where a parent of a home purchaser cosigns the note for a child but the parent takes no interest in the residence, it is not necessary that the parent meet the 3-year requirement since the parent is not a mortgagor of the residence.

(4) *Included interests.* Examples of interests which constitute present ownership interests are the following:

(i) A fee simple interest;

(ii) A joint tenancy, a tenancy in common, or tenancy by the entirety;

(iii) The interest of a tenant-shareholder in a cooperative;

(iv) A life estate;

(v) A land contract (*i.e.*, a contract pursuant to which possession and the benefits and burdens of ownership are transferred although legal title is not transferred until some later time); and

(vi) An interest held in trust for the mortgagor (whether or not created by the mortgagor) that would constitute a present ownership interest if held directly by the mortgagor.

(5) *Excluded interests.* Examples of interests which do not constitute present ownership interests are the following:

(i) A remainder interest;

(ii) A lease with or without an option to purchase;

(iii) A mere expectancy to inherit an interest in a principal residence;

(iv) The interest that a purchaser of a residence acquires on the execution of a purchase contract; and

(v) An interest in other than a principal residence during the previous 3 years.

(f) *Purchase price requirements*—(1) *In general.* An issue meets the requirements of this paragraph only if the acquisition cost (as defined in § 6a.103A-2(b)(8)) of each residence, other than a targeted area residence, for which owner financing is provided does not exceed 90 percent of the average area purchase price applicable to such residence. In the case of a targeted area residence (as defined in § 6a.103A-2(b)(3)), the acquisition cost may not exceed 110 percent of the average area purchase price applicable to such residence.

(2) *Exception.* Paragraph (1) shall not apply with respect to any qualified home improvement loan (as defined in § 6a.103A-2(b)(9)).

(3) *Average area purchase price.* The term “average area purchase price” means, with respect to any residence, the average purchase price of all single-family residences in the statistical area (as defined in § 6a.103A-2(b)(7)) in which the residence being financed is located for the most recent 12-month period for which sufficient statistical information is available. The determination whether a particular residence meets the purchase price requirement shall be made as of the date on which the commitment to provide the financing is made or, if earlier, the date of purchase of the residence.

(4) *Special rules.* (i) In the case of a qualified rehabilitation loan, the requirements of this paragraph are met if the mortgagor's adjusted basis in the

property as of the completion of the rehabilitation (including the cost of the rehabilitation) meets the requirements of paragraph (f)(1). For this purpose, a rehabilitated residence is to be treated as a residence which has been previously occupied.

(ii) The determination of average area purchase price shall be made separately with respect to—

(A) Residences which have not been previously occupied;

(B) Residences which have been previously occupied; and

(C) One-family, two-family, three-family, and four-family residences.

(5) *Safe harbor limitation.* (i) For purposes of meeting the requirements of this paragraph, an issuer may rely upon average area purchase price limitations published by the Treasury Department for the statistical area in which a residence is located. These safe harbor limitations will be effective for the period stated at the time of publication. An issuer may use a limitation different from such safe harbor limitation for any statistical area (as defined in § 6a.103A-2(b)(7)) for which the issuer has more accurate and comprehensive data.

(ii) The following example illustrates the application of subparagraph (5)(i):

Example. The average area purchase price safe harbor limitation for new single-family residences published by the Treasury Department for the second half of 1981 for the jurisdiction of governmental unit X is \$41,500. However, on July 1, 1981, X determines that its average area purchase price for new single-family residences is actually \$43,000. Such determination is based on a comprehensive survey of residential housing sales in the jurisdiction over the previous calendar year. The data accumulated are based on records maintained by the county clerk's office in X's jurisdiction, which enables X to compute average area purchase prices separately for new and used residences and for one-, two-, three-, and four-family residences. X cannot reasonably update such data more often than once a year. X may use average area purchase prices computed from these data for mortgages made from July 1, 1981, through June 30, 1982, rather than the safe harbor published by the Treasury Department.

(g) *Limitation on aggregate amount of qualified mortgage bonds issued during any calendar year—(1) In general.* An issue meets the requirements of this

section only if the aggregate amount of bonds issued pursuant thereto, when added to the sum of (i) the aggregate amount of qualified mortgage bonds previously issued by the issuing authority during the calendar year and (ii) the amount of qualified mortgage bonds which the issuing authority previously elected not to issue under section 25(c)(2)(A)(ii) and the regulations thereunder during the calendar year, does not exceed the applicable limit ("market limitation") for such authority for such calendar year.

(2) *State housing finance agency.* Except as provided in paragraph (g)(4) of this section, the market limitation for any State housing finance agency for any calendar year shall be 50 percent of the State ceiling for such year. For purposes of the preceding sentence, if any State has more than one housing finance agency all such agencies shall be treated as a single agency.

(3) *Other issuers.* Except as provided in paragraph (g)(4), the market limitation for any issuing authority (other than a State housing finance agency) for any calendar year is an amount equal to that authority's proportionate share of 50 percent of the State ceiling amount for such calendar year. The proportionate share is an amount which bears the same ratio to 50 percent of the State ceiling for such year as—

(i) The average annual aggregate principal amount of mortgages executed during the immediately preceding 3 calendar years for single-family, owner-occupied residences located within the jurisdiction of such issuing authority, bears to

(ii) An average determined in the same way for the entire State.

(4) *Constitutional home rule city.* (i) In determining the market limitation for any constitutional home rule city (as defined in paragraph (b)(2) of this section), subparagraph (3) shall be applied by substituting "100 percent" for "50 percent."

(ii) In a State with one or more constitutional home rule cities, in computing the market limitation for issuers other than constitutional home rule cities, the State ceiling amount for any calendar year shall be reduced by the aggregate market limitation for

such year for all constitutional home rule cities in the State.

(5) *Overlapping jurisdictions.* (i) For purposes of subparagraph (3) of this paragraph, if an area is within the jurisdiction of two or more governmental units, such area shall be treated as only within the jurisdiction of the unit having jurisdiction over the smallest geographical area. However, the governmental unit with jurisdiction over the smallest geographical area may enter into a written agreement to allocate all or a designated portion of such overlapping area to the governmental unit having jurisdiction over the next smallest geographical area.

(ii) Where two governmental units have authority to issue mortgage subsidy bonds and both governmental units have jurisdiction over the identical geographical area, the aggregate principal amount of mortgages on residences located within that area shall be allocated to the governmental unit having broader sovereign powers.

(6) *State ceiling.* (i) Except as provided in paragraph (g)(6)(v), the State ceiling applicable to any State for any calendar year shall be the greater of—

(A) 9 percent of the average annual aggregate principal amount of mortgages executed during the immediately preceding 3 calendar years for single-family, owner-occupied residences located within the jurisdiction of such State, or

(B) \$200,000,000.

Only single-family owner-occupied residences (without regard to the definition of such term under § 6a.103A-1(b)(6)) may be used in determining the market limitation regardless of whether or not residences with up to four family units are to be financed by the program. First and second mortgages or mortgages used to refinance an existing mortgage shall be used in making such determination. Liens, special assessments, and similar encumbrances may not be taken into consideration.

(ii) For mortgages on residences with more than one family unit, the full amount of the mortgage shall be applied toward the market limitation and not merely that portion allocable to the owner-occupied unit.

(iii) For purposes of determining the State ceiling amount applicable to any

State for any calendar year an issuer may rely upon the State ceiling amount published by the Treasury Department for such calendar year. An issuer may rely on a different State ceiling amount than such safe-harbor limitation where the issuer has made a more accurate and comprehensive determination of such amount.

(iv) The following example illustrates the application of subparagraphs (3) and (6) of this paragraph (g):

Example. Pursuant to the allocation rule provided in subparagraph (3), City Y determines that its maximum market limitation in 1981 is \$15,000,000. This determination is based on records maintained by the county clerk's office from which data for the preceding 3 years have been accumulated by City Y as to the number of sales of single-family homes in City Y's jurisdiction, the purchase price in each such sales transaction, the number of such sales that were financed by mortgages and the volume of second mortgages and refinancing on previously purchased owner-occupied single-family residences. This information, combined with estimates made by City Y of the average mortgage-loan-to-purchase-price ratio and the ratio of sales of single-family, owner-occupied residences to all sales of single-family residences from a representative sample of sales transactions, enables Y to estimate the preceding 3 years' annual aggregate mortgage volume by using the following formula:

$$v = 1/3 \sum_{i=t-3}^{t-1} (u_i \cdot w_i \cdot x_i \cdot y_i \cdot z_i) + a_i,$$

where

v=The preceding 3 years' average annual aggregate volume of mortgages on single-family, owner-occupied residences in City Y,

u_i =Number of sales of single-family residences,

w_i =Average purchase price of all sales,

x_i =Percent of all sales transactions that were financed with mortgages,

y_i =Estimated average mortgage-loan-to-purchase-price ratio,

z_i =Estimated percent of sales that were owner-occupied residences,

a_i =Total volume of second mortgages and refinancing on previously purchased owner-occupied, single-family residences,

i =The annual period of calculation, and

t =The current year.

City Y determines its applicable limit for 1981 based on the following formula:

$L = 0.5 (v/s) r$, where

L =Market limitation for City Y for the current year,

s=The preceding 3 years' average annual aggregate volume of mortgages on single-family, owner-occupied residences in State X, and

r=Ceiling for State X (*i.e.*, r=the greater of .09s or \$200,000,000).

City Y may use the Treasury estimate of s which will be published with the mortgage volume safe harbor limitation. City Y may rely on its determination of its market limitation for obligations issued during 1981.

(v) *Reduction in State ceiling.* If for any calendar year an issuer of mortgage credit certificates, as defined in section 25 and the regulations thereunder, fails to meet the requirements of section 25 (d)(2) and the regulations thereunder, relating to the limit on the aggregate amount of mortgage credit certificates that may be issued, the applicable State ceiling under paragraph (g)(6)(i) of this section for the State in which the program operates will be reduced by 1.25 times the correction amount (as defined in section 25 (f)(2) and the regulations thereunder) with respect to that failure for the calendar year following the calendar year in which the Commissioner determines the correction amount with respect to that failure.

(7) *Excess obligations.* Where an issue of obligations when added to the aggregate amount of bonds issued by the same issuing authority in the same calendar year exceeds the market limitation determined in accordance with this paragraph (g), no portion of the issue will be treated as a qualified mortgage bond issue, and interest on such obligations shall be subject to Federal income taxation. However, previously issued qualified mortgage bond issues which met the market limitation at the time of their issuance will not cease to be qualified mortgage bond issues even though a subsequent issue causes the aggregate amount of obligations to exceed such limitation for a calendar year.

(8) *Transitional rule obligations.* In applying this paragraph (g) to any calendar year, there shall not be taken into account any bond which, by reason of section 1104 of the Mortgage Subsidy Bond Tax Act of 1980 (94 Stat. 2670) (relating to transitional rules), receives the same tax treatment as bonds issued on or before April 24, 1979.

(9) *Procedure for providing a different allocation.* (i) A State may, by law enacted after December 5, 1980, provide a different formula for allocating the State ceiling amount among the governmental units in such State (other than constitutional home rule jurisdictions) having authority to issue qualified mortgage bonds.

(ii) The governor of any State may proclaim a different formula than provided in subparagraphs (g)(2) and (g)(3) for allocating the State ceiling amount among the governmental units in such State having authority to issue qualified mortgage bonds. The authority of the governor to proclaim a different formula shall not apply after the earlier of—

(A) The 1st day of the 1st calendar year beginning after the 1st calendar year after 1980 during which the legislature of the State met in regular session, or

(B) The effective date of any State legislation dealing with such ceiling enacted after December 5, 1980.

If, on or before either date, the governor of any State exercises the authority to provide a different allocation, such allocation shall be effective until the date specified in (B).

(iii) Unless otherwise provided in a State constitutional amendment or by law changing the home rule provisions adopted in the manner provided by the State constitution, the allocation of that portion of the State ceiling which is allocated to any constitutional home rule city may not be changed by the governor or State legislature unless such city agrees to such different allocation.

(iv) Where a State elects to make a different allocation in accordance with subdivision (i) or (ii) of this subparagraph, the determination as to whether a particular bond issue meets the requirements of paragraph (g) of this section will be based upon the allocation in effect at the time such bonds were issued. Moreover, the authority to provide for a different allocation may not be used directly or indirectly to increase the State ceiling amount.

(v) An issuing authority located in a State with one or more constitutional home rule cities may use an alternative method to those provided in

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subparagraphs (2), (3), and (4) for determining such issuing authority's market limitation if, prior to issuing any obligations for the calendar year, it demonstrates to the satisfaction of the Commissioner that—

(A) The use of the methods provided in subparagraph (2), (3), or (4) would impose an unreasonable hardship on the issuing authority, and

(B) Such alternative method is reasonable.

(h) *Portion of loans required to be placed in targeted areas*—(1) *In general.* An issue meets the requirements of this paragraph only if—

(i) The portion of the lendable proceeds (as defined in § 6a.103A-2(b)(1)) of the issue specified in subparagraph (2) is made available for owner financing of targeted area residences (as defined in § 6a.103A-2(b)(3)) for at least 1 year after the date on which owner financing is first made available with respect to targeted area residences, and

(ii) The issuer attempts with reasonable diligence to place such proceeds in qualified mortgages.

Proceeds are considered first made available with respect to targeted area residences on the date on which any financing of mortgages with the lendable proceeds of an issue first becomes available. Reasonable diligence requires that the issuer and the loan originators use reasonable efforts in trying to place mortgages in targeted areas, such as by advertising that mortgage funds are available for targeted areas. Reasonable diligence is not shown by merely providing in the governing instruments that the required amount be set aside for targeted areas.

(2) *Specified portion.* The specified portion of lendable proceeds of an issue required to be made available in targeted areas is the lesser of—

(i) 20 percent of the lendable proceeds, or

(ii) 40 percent of the average annual aggregate principal amount of mortgages executed during the immediately preceding 3 calendar years for single-family, owner-occupied residences in targeted areas within the jurisdiction of the issuing authority.

(3) *Safe harbor.* For purposes of computing the required portion of proceeds

specified in subparagraph (2)(ii) of this paragraph, where such provision is applicable, an issuer may rely upon the amount produced by the following formula:

$$P = .2(X/Y \times Z),$$

where

P=Required portion to be made available in targeted areas,

X=Average annual aggregate principal amount of mortgages executed during the immediately preceding 3 calendar years for single-family, owner-occupied residences within the State in which the issuing jurisdiction is located,

Y=The total population within the State, based on the most recent decennial census for which data are available, and

Z=The total population in the targeted areas located within the issuer's jurisdiction, based on the most recent decennial census for which data are available.

The issuing jurisdiction may use the Treasury Department estimate of X which will be published with the mortgage volume safe harbor limitation.

(4) *Minimum amount.* (i) The specified portion required to be made available in targeted areas is a minimum amount. More than the minimum amount may be (but need not be) made available in targeted areas.

(ii) With respect to any proceeds not required to be made available in targeted areas, the requirements of this paragraph do not abrogate the requirement of the arbitrage rules that due diligence be used in placing lendable proceeds into mortgages.

(i) *Arbitrage and investment gain*—(1) *In general.* An issue meets the requirements of this paragraph only if such issue meets the requirements of subparagraphs (2), (3), and (4) of this paragraph. For purposes of these requirements, all determinations of yield, effective interest rates, and amounts required to be paid or credited to mortgagors under paragraph (i)(4)(i) of this section shall be made on an actuarial basis taking into account the present value of money. The requirements of section 103A(i) and this paragraph are applicable in addition to the requirements of section 103(c) and §§ 1.103-13, 1.103-14, and 1.103-15.

(2) *Effective rate of mortgage interest not to exceed bond yield by more than 1*

percentage point—(i) *Maximum yield.* An issue of qualified mortgage bonds shall be treated as meeting the requirements of this subparagraph only if the excess of—

(A) The effective rate of interest on the mortgages financed by the issue, over

(B) The yield on the issue, is not greater over the term of the issue than 1 percentage point.

(ii) *Effective rate of interest.* (A) In determining the effective rate of interest on any mortgage for purposes of this subparagraph, there shall be taken into account all fees, charges, and other amounts borne by the mortgagor which are attributable to the mortgage or to the bond issue. Such amounts include points, commitment fees, origination fees, servicing fees, and prepayment penalties paid by the mortgagor.

(B) Items that shall be treated as borne by the mortgagor and shall be taken into account in calculating the effective rate of interest also include—

(1) All points, commitment fees, origination fees, or similar charges borne by the seller of the property;

(2) The excess of any amounts received from any person other than the mortgagor by any person in connection with the acquisition of the mortgagor's interest in the property over the usual and reasonable costs incurred by a person acquiring like property where owner financing is not provided through the use of qualified mortgage bonds.

(C) The following items shall not be treated as borne by the mortgagor and shall not be taken into account in calculating the effective rate of interest:

(1) Any expected rebate of arbitrage profit (as required by § 6a.103A-2(i)(4)).

(2) Any application fee, survey fee, credit report fee, insurance fee or similar settlement or financing cost to the extent such amount does not exceed amounts charged in such area in cases where owner financing is not provided through the use of qualified mortgage bonds. For example, amounts paid for FHA, VA, or similar private mortgage insurance on an individual's mortgage need not be taken into account so long as such amounts do not exceed the amounts charged in the area with respect to a similar mortgage that is not

financial with qualified mortgage bonds. Premiums charged for pool mortgage insurance will be considered amounts in excess of the usual and reasonable amounts charged for insurance in cases where owner financing is not provided through the use of qualified mortgage bonds.

(D)(I) Where amounts other than those derived from the proceeds of a mortgage subsidy bond are used to finance single-family residences such amounts will not be treated as the proceeds of a qualified mortgage bond issue and will not be subject to the limitations set forth in subparagraphs (2), (3), and (4) of this paragraph (i). Such amounts may, however, be treated as proceeds for purposes of the requirements of section 103(c) and the regulations thereunder. Thus, the portion of the mortgage pool financed by the proceeds of a qualified mortgage bond issue will be subject to the limitations of subparagraphs (2), (3), and (4) of this paragraph (i), while the portion not provided with bond proceeds will not be subject to such limitations. The interest rate, points, origination fees, servicing fees, and other amounts charged with respect to that portion of a mortgage loan financed with non-bond amounts may not exceed the reasonable and customary amount which would be charged where financing is not provided through a qualified mortgage bond issue. Where the charge does exceed such reasonable and customary amount, any excess will be taken into account in computing the effective interest rate on the portion of the loan provided with the proceeds of the qualified mortgage bond issue. Furthermore, where such fees and other charges are less than the reasonable and customary charges, the issuer may not allocate that portion of the charges on the loan amounts made with bond proceeds which is equal to such differential to loan amounts made with non-bond proceeds.

(2) If any mortgage is allocated to two or more sources of funds, the receipt of amounts which are described in paragraph (i)(2)(ii) (A) and (B) of this section, repayments of principal, or payments of interest on such mortgage must be allocated to each source of funds.

(E) The effective rate of interest on any mortgage shall be determined in a manner consistent with actuarial methods and shall take into account the discounted value of all amounts from the time received to an amount equal to the “purchase price” of the mortgage. Such discount rate is the effective rate of interest on the mortgages. The “purchase price” of a mortgage means the net amount loaned to the mortgagor. For example, if a mortgage loan is in the amount of \$30,000 and the mortgagor is charged one point (\$300) as an origination fee which amount is deducted from loan proceeds available to the mortgagor, the purchase price is \$29,700. If interest on an issue is paid semiannually, all regular monthly mortgage payments and prepayments of principal may be treated as being received at the end of each semiannual debt service period.

(1) If interest on an issue is paid semiannually, all regular monthly mortgage payments may be treated as being received at the end of each semiannual debt service period.

(2) Prepayments of principal shall be treated as being received on the last day of the month in which the issuer reasonably expects to receive such prepayments.

(F) The rate shall be determined on a composite basis for all mortgages financed by the issue.

(iii) *Example.* The following example illustrate the provisions of subparagraph (2)(ii) of this paragraph:

Example. Purchaser A contracts with seller B, who is represented by real estate agent C, for the purchase of B's residence for \$65,000. A applies to County X for a mortgage provided by the proceeds of a qualified mortgage bond. County X requires that agent C provide it with a principal residence affidavit as well as verify the purchase price of the residence and the location of the purchasers previous residences. Due to the increased administrative burden imposed on agent C by County X, C charges B a real estate commission of 8 percent (\$5,200), rather than 6 percent (\$3,900). The normal real estate commission is 6 percent. Since the 8 percent commission charged by C and paid by B is in excess of the usual and reasonable real estate commission where owner financing is not provided through the use of qualified mortgage bonds, 2 percent (\$1,300) shall be treated as borne by A and taken into account in cal-

culating the effective rate of interest on the mortgage.

(iv) *Prepayment assumption.* In determining the effective rate of interest on mortgages, it shall be assumed that the mortgage prepayment rate for mortgages made out of both original proceeds and mortgages that the issuer expects with reasonable certainty to be made out of prepayments of principal will be equal to 100 percent of the rate set forth in the most recent mortgage maturity experience table for mortgages having the same term insured under section 203 of the National Housing Act and published by the Federal Housing Administration in “Survivorship and Decrement Tables for HUD/FHA Home MORTGAGE Insurance Program” for the region, or, if available, the State in which the residence is located. For purposes of applying these tables, either the original balance method or the declining balance method of calculating mortgage loan prepayments may be used. For proceeds used to finance qualified home improvement loans or shorter term qualified rehabilitation loans for which there are no comparable FHA mortgage maturity experience tables, the assumption used by the issuer as to the rate of prepayment shall be based upon the reasonable expectations of the issuer, as reflected, where applicable, by the issuer's prior experience with such loans.

(v) *Net losses.* The projected net losses on the mortgage pool (after foreclosure and payment of insurance proceeds), based on the most recent default experience for the area in which the residences are located, shall be taken into consideration in calculating the effective rate of interest on the mortgages. However, where mortgages provided under an issue are insured with FHA, VA, or private mortgage insurance, in conjunction with pool mortgage insurance, the expected net losses will be presumed to be zero. In the event that the actual losses on the mortgage pool exceed the projected net losses which were taken into consideration in calculating the effective rate of interest on the mortgages, investment proceeds earned from nonmortgage assets may be used to recover the excess losses and

need not be paid or credited to the mortgagors under § 6a.103A-2(i)(4).

(vi) *Yield on the issue.* (A) The yield on an issue of qualified mortgage bonds shall be calculated on the basis of—

(1) The issue price, and

(2) An expected maturity for the bonds which is consistent with the prepayment assumption required under subparagraph (2)(iv) of this paragraph.

The expected maturity will be considered consistent with such prepayment assumption if all prepayments are assumed to be used to call bonds proportionately (*i.e.*, a “strip” call). The preceding sentence shall not apply to prepayments of mortgages provided from original proceeds to the extent such prepayments are used to provide mortgages.

(B) For purposes of (1) of this subdivision (vi), the term “issue price” shall have the same meaning as in section 1232(b)(2). Thus, in general, such term means the initial offering price to the public, not including bond houses and brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers, at which price a substantial amount of such obligations were sold or, if privately placed, the price paid by the first buyer of such obligations or the acquisition cost of the first buyer.

(3) *Nonmortgage investments*—(i) *Maximum investment.* Except as provided in subdivision (ii) of this subparagraph, an issue meets the requirements of this subparagraph only if—

(A) At no time during any bond year does the aggregate amount invested in nonmortgage investments, *e.g.*, reasonably required reserve funds, with a yield materially higher than the yield on the issue exceed 150 percent of the debt service on the issue for the current bond year, and

(B) Such aggregate amount invested in nonmortgage assets with a yield materially higher than the yield on the issue is promptly and appropriately reduced as mortgages are repaid.

The amount subject to the maximum investment rule in subdivision (i)(A) of this subparagraph includes the original bond proceeds, investment proceeds and repayments of principal on the mortgages. For purposes of subdivision (B), the amount described in subdivi-

sion (A) shall be considered promptly and appropriately reduced if beginning in the first bond year after the expiration of the temporary period for original proceeds described in subdivision (ii)(A) of this subparagraph, such amount is reduced within 30 days of the beginning of each bond year by an amount equal to the difference between the average scheduled monthly mortgage receipts for the bond year (excluding any receipts that were scheduled with respect to mortgages that were discharged in the preceding bond year) and the average scheduled monthly mortgage receipts for the preceding bond year.

(ii) *Temporary periods.* Subparagraph (3)(i) of this paragraph shall not apply to—

(A) Proceeds (including prepayments of principal designated to be used to acquire additional mortgages) of the issue invested for an initial temporary period not to exceed 1 year (1½ years for proceeds required to be set aside for placing mortgages in targeted areas) until such proceeds are needed for mortgages, and

(B) Repayments of principal and interest on mortgages that are contributed to a bona fide debt service fund (as defined in § 1.103-13(b)(12)) and invested for a 13-month temporary period as provided in § 1.103-14(b)(10).

(iii) *Debt service defined.* For purposes of subparagraph (3)(i)(A) of this paragraph, the debt service on the issue for any bond year is the scheduled amount of interest and amortization of principal payable for such year with respect to such issue. There shall not be taken into account amounts scheduled with respect to any bond which has been retired before the beginning of the bond year.

(iv) *Nonmortgage investments.* A nonmortgage investment is any investment other than an investment in a qualified mortgage. For example, a mortgage-secured certificate or obligation is a nonmortgage investment. Investment earnings from participation fees (described in § 6a.103A-1(b)(5)) are treated as investment proceeds on nonmortgage investments unless such fees are used to pay debt service or to finance owner occupied residences.

(v) *Bonds issued after June 30, 1993.* Section 1.148-2(f)(2)(iv) applies to bonds issued after June 30, 1993, in lieu of this paragraph (i)(3).

(4) *Arbitrage and investment gains to be used to reduce costs of owner financing—*

(i) *Rebate requirement.* An issue shall be treated as meeting the requirements of this subparagraph only if an amount equal to the sum of:

(A) The excess of—

(1) The net amount earned on all nonmortgage investments pursuant to subparagraph (3)(i) and (ii) of this paragraph (other than investments attributable to an excess described in this subdivision (A)) over

(2) The amount which would have been earned if the investments were invested at a rate equal to the yield on the issue, plus

(B) Any income attributable to the excess described in subdivision (A),—

shall be paid or credited to the mortgagors as rapidly as practicable. Such amount may be disproportionately distributed to the mortgagors if the larger portion of such amount is distributed to lower income mortgagors. The determination of the excess described in subdivision (A) shall take into account any reinvestment of nonmortgage investment receipts and any gain or loss realized on the disposition of nonmortgage investments. In addition, where nonmortgage investments are retained by the issuer after retirement of an issue, any unrealized gains or losses as of the date of retirement of such issue must be taken into account, in calculating the amount to be rebated to the mortgagors. The amount described in subdivision (A)(2) is the amount that would have been earned if the investments in nonmortgage obligations were invested at a rate equal to the yield on the issue calculated in the same manner as provided in § 6a.103A-2(i)(2)(vi) and by using the same compounding method. For purposes of subdivision (B), any income attributable to the excess described in subdivision (A) shall be taken into account whether or not such income exceeds the yield on the bonds.

(ii) *Computation period.* Whether earnings are amounts described in subdivision (i) (A) or (B) of this subparagraph shall be determined by making com-

putations on an annual basis. For example, if at the end of the first year the earnings on nonmortgage investments exceed the amount that could have been earned if such investments were invested at the bond yield, the amount of earnings equal to such difference constitutes an excess described in subdivision (i)(A) of this subparagraph. In the following year, investment proceeds earned on such excess must be taken into account, whether or not such earnings exceed the yield on the bonds, and may not be treated as “negative arbitrage”.

(iii) *Paid or credited.* For purposes of subdivision (i) of this subparagraph, amounts are paid or credited to mortgagors as rapidly as practicable if such amounts are paid or credited to such mortgagors at the time the mortgagor discharges the mortgage, for example, through prepayment of the entire principal amount or through making the last regular payment on the mortgage. The amount paid or credited to the mortgagors must have a present value at least equal to the present value of the amount described in subdivision (i) of this subparagraph, using the yield on the bonds as the discount rate. In the case of prepayments, the cumulative amount required to be rebated under subparagraph (4)(i) of this paragraph may be determined as of a date before the actual prepayment but not more than 1 year earlier than the date of prepayment. Except as provided in subparagraph (2)(v) or subparagraph (4)(iv) of this paragraph, such amount may not be subject to the claim of any party, e.g., a bondholder, and may not be paid over to any party other than the mortgagor or the United States.

(iv) *Reduction where issuer does not use full 1 percentage point.* (A) The amount required to be paid or credited to mortgagors under subparagraph (4)(i) of this paragraph shall be reduced by the amount which (if it were treated as an interest payment made by mortgagors) would result in the excess referred to in subparagraph (2)(i) of this paragraph being equal to 1 percentage point. Such amount shall be fixed and determined as of the yield determination date. This fixed dollar amount may be received by the issuer at any time but may not be adjusted for the time of

payment. Such fixed dollar amount shall be equal to the difference between the purchase price of mortgages financed by the proceeds of the issue and the present value of expected payments of principal and interest on such mortgages, using a discount rate equal to the bond yield plus 1 percentage point.

(B) The following example illustrates the provisions of subparagraph (4)(iv)(A) of this paragraph:

Example. In 1981, County X issues obligations to provide mortgages for owner-occupied residences. The yield paid on the obligations is 10 percent, and the effective rate of interest on the mortgages provided by the proceeds of such obligations is 9.75 percent. X maintains a reasonably required reserve fund which is invested at 15 percent and intends to recover that additional amount computed in the manner described in subparagraph (4)(iv) which could have been earned from investment of the proceeds in mortgages with an effective interest rate of 11 percent from the arbitrage earned from the reserve fund nonmortgage assets. X plans to recover such amount from the arbitrage over a period of 3 years; thus, X will not recover such amount until 1984. X may not adjust the amount to be received to account for the time when such amount will be received.

(v) *Election to pay United States.* Subparagraph (4)(i) of this paragraph shall be satisfied with respect to any issue if the issuer elects in writing before issuing the obligations to pay over to the United States—

(A) Not less frequently than once each 5 years after the date of issue, an amount equal to 90 percent of the aggregate amount described in subdivision (i) earned during such period (and not theretofore paid to the United States), and

(B) Not later than 30 days after the redemption of the last obligation, 100 percent of such aggregate amount not theretofore paid to the United States.

(j) *New mortgages—(1) In general.* An issue meets the requirements of this paragraph only if no part of the proceeds of such issue is to be used to acquire or replace an existing mortgage. All of the lendable proceeds must be used to provide mortgage loans to persons who did not have a mortgage (whether or not paid off) on the residence securing the mortgage note at any time prior to the execution of the mortgage.

(2) *Exceptions.* For purposes of this paragraph, the replacement of—

(i) Construction period loans,
(ii) Bridge loans or similar temporary initial financing, and
(iii) In the case of a qualified rehabilitation, an existing mortgage,
shall not be treated as the acquisition or replacement of an existing mortgage. Generally, temporary initial financing is any financing which has a term of 24 months or less.

(3) *Assumptions.* An issue meets the requirement of this paragraph only if a mortgage with respect to which owner financing has been provided under such issue may be assumed only if the requirements of paragraphs (d), (e), and (f) of this section are met with respect to such assumption. The determination of whether these requirements are met is based upon the facts as they exist at the time of the assumption as if the loan were being made for the first time. For example, the purchase price requirement is to be determined by reference to the average area purchase price at the time of the assumption and not when the mortgage was originally placed. If the bond documents and relevant mortgage instruments provide that a mortgage may be assumed only if the issuer has determined that the conditions stated in this subparagraph are satisfied, the good faith and 95-percent requirements of paragraph (c)(1)(i) and (ii) of this section will be considered satisfied with respect to the requirements of this subparagraph at the time the mortgages were executed. However, any failure to meet the requirements of this subparagraph at the time a mortgage is assumed is subject to the remedy requirement in paragraph (c)(1)(iii) of this section.

(4) *Examples.* The following examples illustrate the application of this paragraph (j):

Example (1). In June 1981 mortgagor A obtained a mortgage from a private lending institution in order to construct a house on land which A purchased without a mortgage in May 1981. In January 1982 A applies to obtain permanent financing on the residence from a program sponsored by State housing finance agency Y. Such program is funded with the proceeds of qualified mortgage bonds. If A meets the other requirements of this section, A qualifies for such permanent financing since the replacing of construction

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financing is not treated as the acquisition or replacement of an existing mortgage.

Example (2). In June 1981 mortgagor B purchased a new residence in a targeted area but was unable to sell his former residence. Therefore, B obtained temporary financing for his new residence until his former residence was sold. In October 1981 B applies to County Z to obtain financing from a program funded with proceeds of qualified mortgage bonds. Such financing is needed by B to replace the temporary financing for his new residence. If B meets the other requirements of this section, the mortgage qualifies for such permanent financing since the permanent financing replaces temporary initial financing.

Example (3). In 1979 mortgagor C purchased a residence but was unable to obtain financing from a program sponsored by County W because such program prohibited loans from the program which were in excess of 80 percent of the fair market value of the property. Therefore, in 1979 C obtained financing from a private lending institution with the intention of refinancing when he accumulated sufficient equity in the property. In 1981 C has accumulated sufficient equity in the property so as to comply with the requirements of the program. C applies to County W to refinance under the program, which is funded with the proceeds of qualified mortgage bonds. Even if C met the other requirements of this section, the mortgage would fail to meet the requirement of paragraph (j) since such a mortgage would replace an existing mortgage.

Example (4). In 1969 mortgagor D purchased a residence and obtained financing from a private lending institution. In 1981 D applies to County U for a loan for the rehabilitation of the property and for the refinancing of the existing mortgage. The program is funded with qualified mortgage bonds. If D meets the other requirements of this section the mortgage qualifies for such permanent financing since the replacement of the mortgage is not treated as the replacement or acquisition of an existing mortgage.

Example (5). In 1950 mortgagor E purchased a residence, obtaining a mortgage from a private lending institution to finance the purchase price. In 1980 E completed repaying the mortgage. In 1981 E applies for a loan from a program sponsored by State housing finance agency X and funded with the proceeds of qualified mortgage bonds. The mortgage does not meet the requirements of paragraph (j) since E had a previous mortgage on his residence, even though such mortgage was previously released.

(k) *Information reporting requirement.* See § 1.103A-2(k) for rules relating to section 103A(j)(3).

(l) *Policy statement.* See § 1.103A-2(l) for rules relating to section 103A(j)(5).

(m) *State certification.* See § 1.103A-2(m) for rules relating to section 103A(j)(4).

(98 Stat. 901 (26 U.S.C. 103A(j) (3) and (4)); 68A Stat. 917 (26 U.S.C. 7805))

[T.D. 7780, 46 FR 34314, July 1, 1981, as amended by T.D. 7794, 46 FR 55514, Nov. 10, 1981; T.D. 7817, 47 FR 22361, May 24, 1982; T.D. 7819, 47 FR 24701, June 8, 1982; T.D. 7821, 47 FR 28094, June 29, 1982; T.D. 7995, 49 FR 48293, Dec. 12, 1984; T.D. 8023, 50 FR 19355, May 8, 1985; T.D. 8049, 50 FR 35547, Sept. 3, 1985; T.D. 8476, 58 FR 33553, June 18, 1993]

§ 6a.103A-3 Qualified veterans' mortgage bonds.

(a) *In general.* A qualified veterans' mortgage bond shall not be treated as a mortgage subsidy bond, and the interest shall be exempt from Federal income taxation.

(b) *Qualified veterans' mortgage bond.* (1) With respect to obligations issued prior to July 19, 1984, the term "qualified veterans' mortgage bond" means any issue of obligations—

(i) Which meets the requirements of § 6a.103A-1, § 6a.103A-2(j) (1) and (2), and this section;

(ii) Substantially all of the proceeds of which are to be used to provide financing for single-family, owner-occupied residences (which meet the requirements of § 6a.103A-1(b)(6) and § 6a.103A-2(d)) for veterans; and

(iii) Payment of the principal and interest on which is secured by a pledge of the full faith and credit of the issuing State.

A qualified veterans' mortgage bond does not include any bond that is an industrial development bond under section 103(b).

(2) With respect to obligations issued after July 18, 1984, the term "qualified veterans' mortgage bond" means any issue of obligations—

(i) Which meets the requirements of § 6.103A-1, § 6a.103A-2(d) (relating to residence requirements), (j) (1) and (2) (relating to new mortgage requirement), and (k) (relating to information reporting requirement), and this section;

(ii) Substantially all of the proceeds of which are to be used to provide financing for qualified veterans; and

(iii) Payment of the principal and interest on which is secured by a pledge

of the full faith and credit of the issuing State.

A qualified veterans' mortgage bond does not include any bond that is an industrial development bond under section 103(b).

(c) *Qualified veteran.* (1) An issue meets the requirements of this paragraph only if each of the mortgagors to whom owner financing is provided is a qualified veteran.

(2) With respect to obligations issued prior to July 19, 1984, the term "qualified veteran" means any veteran.

(3) With respect to obligations issued after July 18, 1984, the term "qualified veteran" means any veteran who—

(i) Served on active duty at some time before January 1, 1977, and

(ii) Applied for financing before the later of—

(A) The date 30 years after the date on which such veteran left active service, or

(B) January 1, 1985.

(4) The term "veteran" shall have the same meaning as in 38 U.S.C. 101(2), that is, a person who served in the active military, naval, or air service, and who was discharged or released therefrom under conditions other than dishonorable.

(d) *Husband and wife.* For purposes of this section, if a residence is to be owned by a husband and wife as joint tenants, as tenants by the entirety, or as community property, and if one spouse is a veteran, then both spouses shall be treated as satisfying the requirements of paragraph (c) of this section.

(e) *Substantially all.* For purposes of this section, the term "substantially all" shall have the same meaning as in § 1.103-8.

(f) *Qualified home improvement loan.* The term "qualified home improvement loan" means the financing (whether or not secured by a mortgage) of alterations, repairs, and improvements on, or in connection with, an existing single-family, owner-occupied residence by a veteran who is the owner thereof. The alterations, repairs, and improvements, however, must substantially protect or improve the basic livability or energy efficiency of the property, such as the renovation of plumbing or electric systems, the in-

stallation of improved heating or air conditioning systems, the addition of living space, or the renovation of a kitchen area. Items that will not be considered to substantially protect or improve the basic livability of the property include swimming pools, tennis courts, saunas, or other recreational or entertainment facilities.

(g) *Volume limitation—(1) In general.* In the case of obligations issued after June 22, 1984, an issue meets the requirements of this paragraph only if the aggregate amount of obligations issued pursuant thereto, when added to the aggregate amount of qualified veterans' mortgage bonds previously issued by the State during the calendar year, does not exceed the State veterans limit for such calendar year. In determining the aggregate amount of qualified veterans' mortgage bonds issued in calendar year 1984, obligations issued prior to June 23, 1984, shall not be taken into account.

(2) *State veterans limit.* (i) The State veterans limit for any State is the amount equal to—

(A) The aggregate amount of qualified veterans' mortgage bonds issued by the State during the period beginning on January 1, 1979, and ending on June 22, 1984 (not including the amount of any qualified veterans' mortgage bonds actually issued during the calendar year, or the applicable portion of 1984, in such period for which the amount of such bonds was the lowest), divided by

(B) The number (not to exceed 5) of calendar years after 1978 and before 1985 during which the State issued qualified veterans' mortgage bonds.

In determining the number of calendar years after 1978 and before 1985 during which the State issued qualified veterans' mortgage bonds, any qualified veterans' mortgage bonds issued after June 22, 1984, shall not be taken into account. A State that did not issue qualified veterans' mortgage bonds during the period beginning on January 1, 1979, and ending on June 22, 1984, may not issue qualified veterans' mortgage bonds after June 22, 1984.

(ii) In the case of any obligation which has a term of 1 year or less and which was issued to provide financing for property taxes, the amount taken

into account under this paragraph with respect to such obligation shall be $\frac{1}{15}$ of its principal amount.

(3) *Examples.* The following examples illustrate the provisions of this paragraph:

Example (1). State R issued the following issues of qualified veterans' mortgage bonds: a \$200 million issue on March 31, 1979, a \$150 million issue on May 1, 1980, a \$75 million issue on September 1, 1981, a \$200 million issue on June 5, 1982, a \$125 million issue on March 1, 1983, a \$60 million issue on April 1, 1984, and a \$100 million issue on September 1, 1984. R issued no other issues of qualified veterans' mortgage bonds during the period beginning January 1, 1979, and ending on December 31, 1984. The aggregate amount of qualified veterans' mortgage bonds issued during the period January 1, 1984, through June 22, 1984 (\$60 million), is not taken into account in determining R's State veterans limit because that is the lowest aggregate amount of qualified veterans' mortgage bonds issued during the calendar year or the applicable portion of 1984, in the period beginning on January 1, 1979, and ending on June 22, 1984. Thus, R's State veterans limit is \$150 million (\$750 million (which is the sum of \$200 million, \$150 million, \$75 million, \$200 million, and \$125 million) divided by 5). The September 1, 1984, issue is not included in determining the State veterans limit because that issue was issued after June 22, 1984. The September 1, 1984, issue of qualified veterans' mortgage bonds meets the requirements of § 6a.103A-3 (g) since the aggregate amount of qualified veterans' mortgage bonds issued in calendar year 1984 (not including obligations issued prior to June 23, 1984), does not exceed the State veterans limit.

Example (2). State S issued a \$100 million issue of qualified veterans' mortgage bonds on March 31, 1984. S issued no other issues of qualified veterans' mortgage bonds during the period beginning on January 1, 1979, and ending on June 22, 1984. The aggregate amount of qualified veterans' mortgage bonds issued in the calendar year, or the applicable portion of 1984, in the period January 1, 1979, through June 22, 1984, for which the amount of bonds was the lowest is zero. Thus, the State veterans limit for S is \$100 million ((\$100 million minus \$0) divided by 1).

(h) *Good faith compliance efforts—(1) Mortgage eligibility requirements.* An issue of qualified veterans' mortgage bonds issued after July 18, 1984, which fails to meet the requirements of section 103A(o)(1), § 6a.103A-2(d) relating to residence requirements), and § 6a.103A-2(j) (1) and (2) (relating to new mortgage requirements) shall be treated as meeting such requirements if

each of the following provisions is complied with:

(i) The issuer in good faith attempted to meet all such requirements before the mortgages were executed. Good faith requires that the trust indenture, participation agreements with loan originators, and other relevant instruments contain restrictions that permit the financing of residences only in accordance with such requirements. In addition, the issuer must establish reasonable procedures to ensure compliance with such requirements. Such procedures include reasonable investigations by the issuer to satisfy such requirements.

(ii) Ninety-five percent or more of the lendable proceeds (as defined in § 6a.103A-2(b)(1)) that were devoted to owner-financing were devoted to residences with respect to which, at the time the mortgages were executed, all such requirements were met. In determining whether a person is a qualified veteran the issuer may rely on copies of the mortgagor's certificate of discharge indicating that the mortgagor served on active duty at some time before January 1, 1977, and stating the date on which the mortgagor left active service provided that neither the issuer nor its agent knows or has reason to believe that such affidavit is false. Where a particular mortgage fails to meet more than one of these requirements, the amount of the mortgage will be taken into account only once in determining whether the 95-percent requirement is met. However, all of the defects in the mortgage must be corrected pursuant to subdivision (iii).

(iii) Any failure to meet such requirements is corrected within a reasonable period after such failure is discovered. For example, failures can be corrected by calling the nonqualifying mortgage or by replacing the nonqualifying mortgage with a qualifying mortgage.

(2) *Nonmortgage eligibility requirements.* An issue of qualified veterans' mortgage bonds issued after July 18, 1984, which fails to meet the requirements of paragraph (g) of this section

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shall be treated as meeting such requirements if each of the requirements of § 6a.103A-2(c)(2) (i) and (ii) is met.

(98 Stat. 901 (26 U.S.C. 103A(j) (3) and (4)); 68A Stat. 917 (26 U.S.C. 7805))

[T.D. 7780, 46 FR 34314, July 1, 1981; 46 FR 37890, July 23, 1981, as amended by T.D. 7995, 49 FR 48297, Dec. 12, 1984]

§ 6a.6652(g)-1 Failure to make return or furnish statement required under section 6039C.

(a) *Amount imposed.* In the case of each failure to meet the requirements of—

(1) Section 6039C, relating to information returns with respect to United States real property interests, or

(2) Section 6039C(b)(3), relating to statements to be provided to substantial investors in United States real property interests,

on or before the date prescribed therefor (determined with regard to any extension of time for filing), the person failing to meet such requirement shall pay \$25 for each day during which such failure continues.

(b) *Limitation—(1) Domestic corporations and nominees.* The maximum penalty which may be imposed under paragraph (a) of this section on a domestic corporation or nominee for failure to meet the requirements of section 6039C(a) for any calendar year is \$25,000.

(2) *Partnerships, trusts, estates and foreign corporations.* The maximum penalty which may be imposed on a partnership, trust, estate or foreign corporation for failure to meet the requirements of section 6039C(b) for any calendar year is \$25,000.

(3) *Foreign persons holding U.S. real property interests and nominees.* The maximum penalty which may be imposed on a foreign person holding a U.S. real property interest or on a nominee holding a U.S. real property interest for a foreign person for failure to meet the requirements of section 6039C(c) for any calendar year is the lesser of \$25,000 or 5 percent of the aggregate of the fair market value of the U.S. real property interests owned by such person at any time during such calendar year.

(c) *Definitions—(1) Fair market value.* The term “fair market value” as used

in this section is defined in § 6a.897-1 (in the FEDERAL REGISTER 47 FR 41541, Sept. 21, 1982).

(2) *Failure.* The term “failure to meet the requirements of section 6039C” includes the failure to file a return for any calendar year on the date prescribed therefor (determined with regard to any extension of time for such filing), or the omission on a return of one or more items of information required by section 6039C and the regulations thereunder to be provided on the return. It also includes the failure to furnish a statement required by section 6039C(b)(3). The failure to furnish a return required under section 6039C(b)(1) and the failure to furnish a statement to a substantial investor as required by section 6039C(b)(3), are separate failures for purposes of paragraph (a) of this section. Also, each failure to provide a statement to each substantial investor is a separate failure for purposes of paragraph (a). Thus, if an entity has 100 substantial investors as defined in section 6039C and fails to furnish any of the required statements to substantial investors, there are 100 separate failures to furnish the required statement.

(3) *Aggregate of the fair market value of the United States real property interests.* The “aggregate of the fair market value of the U.S. real property interests” is the total of the fair market values of each U.S. real property interest owned at any time during the calendar year. Fair market value is determined as of December 31 of such year for property held at the end of the year and on the date of disposition for property disposed of during the year.

(d) *Attribution of ownership.* For purposes of calculating the penalty limitation under § 6a.6652(g)-1(b)(3) with respect to failure to meet the requirements of section 6039C(c), U.S. real property interests held by a partnership, trust, or estate shall be treated as owned proportionately by its partners or beneficiaries.

(e) *Exceptions—(1) Provision of security.* If a person otherwise required by section 6039C to file a return for a calendar year or furnish a statement to a substantial investor complies with the requirements of § 6a.6039C-5 relating to furnishing security in lieu of filing

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such return, or is exempt, by virtue of § 6a.6039C-5(f), from filing a return for such year with respect to its U.S. real property interests held, no penalty will be imposed under paragraph (a) of this section for failure to file such return or furnish such statement.

(2) *Showing of reasonable cause.* No amount shall be imposed under paragraph (a) of this section for a failure described in such paragraph if it is established to the satisfaction of the Director of the Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pennsylvania 19155 or in the case of returns concerning the Virgin Islands, the Commissioner of the Bureau of Internal Revenue, Tax Division, Charlotte Amalie, St. Thomas, V.I. 00801, that such failure is due to reasonable cause and not to willful neglect. An affirmative showing of reasonable cause must be made in the form of a written statement, made under the penalties of perjury, containing a declaration by the person failing to make a return or furnish a statement under section 6039C setting forth all the facts alleged as reasonable cause. Whether reasonable cause is shown may depend upon the subsection of section 6039C under which the failure occurs. However, the fact that stock of a foreign corporation, or any other interest in any entity to which this section applies, is registered in bearer form does not constitute reasonable cause under this paragraph (e)(2) of this section for failure to comply with the requirements of section 6039C(b). Also, the fact that disclosure of ownership would contravene a secrecy law of any country does not constitute reasonable cause for failure to comply with the requirements of section 6039C(b). Where a return has been filed and there is an omission of one or more items of information required by section 6039C and the regulations thereunder, one of the facts to be considered in determining whether such failure is due to reasonable cause is the materiality of the item omitted.

(3) *Spouse or parent already filed with respect to same property.* If an individual files a return with respect to all U.S. real property interests held by such individual in accordance with § 6a.6039C-4(b), no penalty shall be imposed under

this section on such individual's spouse or minor child for failure to file a return under § 6a.6039C-4 with respect to the same property.

(f) *Manner of payment.* The amount imposed under paragraph (a) of this section on any person shall be paid in the same manner as tax upon the issuance of a notice and demand therefor.

(g) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). Domestic corporation X is required under section 6039C (a) to make a return for calendar year 1982. X does not file such return on or before May 15, 1983 as required under § 6a.6039C-1(c). The failure to file the return for calendar year 1982 continues throughout calendar years 1983, 1984, 1985, and 1986. The failure to file is not due to reasonable cause and no security has been furnished in lieu of filing. The maximum penalty which can be imposed on X for failure to file the 1982 return is \$25,000, determined as follows:

	Penalty incurred in given year	Cumulative penalty for failure to file 1982 return
Total penalty incurred in 1983 (\$25 per day×230 days)	\$5,750	\$5,750
Total penalty incurred in 1984 (a leap year): (\$25 per day×366 days)	9,150	14,900
Total penalty incurred in 1985 (\$25 per day×365 days)	9,125	24,025
Total penalty incurred in 1986 (lesser of \$25 per day×365 days or \$975 (remaining penalty which may be imposed))	975	25,000

Example (2). The facts are the same as in example (1) except that X also fails to file a return under section 6039C (a) for calendar year 1983. The failure to file its return for calendar year 1983 continues throughout calendar years 1984, 1985, 1986 and 1987. The total penalty which may be imposed on X for failure to file its return for calendar year 1983 is \$25,000. The amount of penalty which can be imposed on X in calendar years 1984, 1985, 1986 and 1987 is determined as follows:

	Penalty for 1982 failure	Penalty for 1983 failure	Total penalty for given year
Penalty incurred in 1984 (a leap year): For failure to file 1982 return (\$25 per day×366 days)	\$9,150	.....	.....

	Penalty for 1982 failure	Penalty for 1983 failure	Total penalty for given year
For failure to file 1983 re- turn (\$25 per day×230 days)		\$5,750	.....
Total			\$14,900
Penalty incurred in 1985:			
For failure to file 1982 re- turn (\$25 per day×365 days)	9,125	.....	.....
For failure to file 1983 re- turn (\$25 per day×365 days)		9,125	.....
Total			18,250
Penalty incurred in 1986:			
For failure to file 1982 re- turn (lesser of \$25 per day×365 days or \$975 (remaining penalty which may be im- posed))	975	.....	.....
For failure to file 1983 re- turn (\$25 per day×365 days)		9,125	.....
Total			10,100
Penalty incurred in 1987:			
For failure to file 1983 re- turn (lesser of \$25 per day×365 days or \$1,000 (remaining penalty which may be imposed))		1,000	.....
Total			1,000

Example (3). Foreign corporation Y is required under section 6039C(b)(1) to make a return for calendar year 1982. In addition, Y is required under section 6039C(b)(3) to furnish statements to each substantial investor in U.S. real property interests. Y has 10 such substantial investors. Y does not file such return on or before May 15, 1983 as required under §6a.6039C-1(c), nor does it furnish the required statements on or before January 31, 1983 as required under §6a.6039C-3(h). The failure to file the return for calendar year 1982 and to furnish the required statements for 1982 continues throughout calendar years 1984 and 1985. The failure to meet the requirements of section 6039C(b) are not due to reasonable cause and no security has been furnished in lieu of filing. The total penalty which can be imposed on Y for failure to file the return and statements required under section 6039C(b) for calendar year 1982 is \$25,000. The amount of penalty incurred by Y in calendar year 1983 for failure to file the return and statements for calendar year 1982 is \$25,000, determined as follows:

Penalty incurred in 1982:	
For failure to file return (\$25 per day×230 days)	\$5,750

For each failure to furnish a statement re- quired by section 6039C(b)(3) (\$25 per day×10 statements×the 334 days from Feb- ruary 1, 1983 to December 31, 1983 (\$83,500) but not more than \$19,250 (which when added to \$5,750 would total \$25,000))	19,250
Total	25,000

Since Y has incurred the maximum penalty for failure to file its return and statements required for 1982 by the end of calendar year 1983, no further penalty for these failures is imposed.

Example (4). Under section 6039C(c) foreign person Y is required to make a return for calendar year 1982. Y does not file such return on May 15, 1983 and the failure is not due to reasonable cause. No security has been furnished in lieu of filing. All properties owned by Y in 1982 are U.S. real property interests. Y purchased property M in January 1982 when its fair market value was \$10,000. In March, Y purchased property N when its fair market value was \$15,000. In November, Y sold property M for \$20,000. The fair market value of property N on December 31, 1982, was \$20,000. The total of the fair market values of M and N (M as of the date of its sale and N as of December 31, 1982) is \$40,000. The maximum penalty which may be imposed on Y for failure to meet the requirements of section 6039C(c) for any calendar year is the lesser of \$25,000 or 5 percent of the aggregate of the fair market values of the U.S. real property interests owned by Y at any time during such calendar year. Since \$2,000 (5 percent of \$40,000) is less than \$5,750 (\$25 times 230 days, the number of days in calendar year 1983 for which the failure continues), the maximum penalty which may be imposed on Y in 1983 is \$2,000. Since the maximum penalty for the failure to file the 1982 return is incurred in 1983, no amount may be imposed for Y's continuing failure to file the return for calendar year 1982 during calendar years after 1983.

(h) *Effective date.* This section shall apply to 1980 and subsequent calendar years. The calendar year 1980 shall be treated as beginning on June 19, 1980 and ending on December 31, 1980.

[T.D. 7866, 48 FR 648, Jan. 6, 1983]

PART 7—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1976

Sec.

7.48-1 Election to have investment credit for movie and television films determined in accordance with previous litigation.

7.48-2 Election of forty-percent method of determining investment credit for movie